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C O N F I D E N T I A L SECTION 01 OF 04 TAIPEI 000246

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COMMERCE FOR 3132/USFCS/OIO/EAP/WZARIT
TREASURY FOR OASIA/LMOGHTADER
USTR FOR STRATFORD, ALTBACH

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TAGS: [FAIR](#) [ECON](#) [PREL](#) [EINV](#) [ETRD](#) [TW](#) [CH](#)

SUBJECT: CLOSING THE FINAL LINK - AVIATION (PART 2 OF 2)

REF: A. TAIPEI 152

- [1](#)B. TAIPEI 133
- [1](#)C. 06 TAIPEI 4173
- [1](#)D. 06 TAIPEI 3473
- [1](#)E. 06 TAIPEI 3446
- [1](#)F. 06 TAIPEI 3414
- [1](#)G. 06 TAIPEI 2376
- [1](#)H. 06 TAIPEI 323
- [1](#)I. 05 TAIPEI 3717
- [1](#)J. 05 TAIPEI 222
- [1](#)K. 03 TAIPEI 219

Classified By: AIT Deputy Director Robert S. Wang, Reason 1.4 b/d

[1](#)1. (C) Summary: The lack of direct air links between Taiwan and the Mainland causes considerable harm to Taiwan's economy. Inconvenient passenger routes change how Taiwan businessmen and foreign investors do business. More expensive air cargo makes Taiwan exporters less competitive. Direct air links would increase investment in Taiwan, foreign trade, the number of residents in Taiwan, and tourists. Tentative progress on direct air links to date has produced an unsatisfactory situation for both sides. AIT will continue to support American businesses in encouraging Taiwan to move forward on direct air links and include foreign passengers and carriers. End summary.

[1](#)2. (U) Of the original three links (san tong) -- postal and telecommunications links (tong you), trade (tong shang), and transportation (tong hang) -- transportation still remains primarily indirect. Ref A reported on the status of cross-Strait maritime links and their impact on the Taiwan economy. This report will examine efforts to establish direct air links and the potential benefits for Taiwan.

Wasting Time on Bad Connections

[1](#)3. (SBU) The lack of direct passenger flights to the Mainland China creates inconvenience, causing considerable harm to Taiwan's economy. In 2005, more than 10 million passengers traveled on flights linking

Taiwan to Hong Kong and Macau. They accounted for 39 percent of Taiwan's international air travelers. Most of them had connecting PRC flights. EVA Air estimates that 60 percent of its Hong Kong passengers and 80 percent of its Macau passengers connect to the PRC flights. In addition, Taiwan airlines also offer connections to Mainland flights through Okinawa, Japan, and Cheju, South Korea.

14. (U) The inconvenience of stopping in Hong Kong, Macau or other connecting airports has a greater impact on Taiwan's economy than the added expense of indirect flights. With a connection in Hong Kong, the average trip to Shanghai takes at least five hours from take-off in Taipei to arrival. Direct charter flights only take three hours. The stop in Hong Kong, Macau or elsewhere makes it impossible to fly to Shanghai in the morning, attend a meeting and get back the same day. This can have a significant impact on how people run their businesses, especially for Taiwan investors in the PRC and foreign investors who want to better integrate their Taiwan and Mainland operations.

Bound by More Cumbersome Supply Chains

15. (C) For air cargo, cost savings could be much more substantial. Michael Chu, Managing Director of FedEx Express in Taiwan, speculated to AIT that with daily cargo flights, the cost of general cargo air shipment could be 20 to 30 percent lower than currently. For express mail with door-to-door service, he believes the savings will be smaller at 10 to 15 percent.

16. (U) Air cargo plays an important role in Taiwan's

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export industry. Taiwan exported more than 567,000 metric tons of goods by air in 2005. Electronic equipment manufactured by Taiwan's powerful high-tech industries accounted for 62 percent of those exports by weight at 350,000 metric tons. Of Taiwan's total exports shipped by air, Mainland China, including the PRC, Hong Kong and Macau, accounted for 30 percent. The United States had the next highest percentage at 18 percent.

17. (U) Cargo is particularly important to Taiwan's major airlines. In 2005, China Airlines and EVA ranked seventh and ninth, respectively, for total scheduled freight flown by ton-kilometers. If combined, they would rank second after FedEx and ahead of UPS. While cargo generally accounts for about half of total revenue for the two airlines, it usually makes up a much higher portion of total profit.

More, More, More

18. (SBU) Direct cross-Strait flights would have few economic drawbacks for Taiwan. Some of the many advantages include the following:

--Domestic Investment - Direct air links would make Taiwan a more attractive investment environment. The Taiwan government has long promoted the goal of making the island a regional operations and logistics center. These plans have been stuck on the runway in no small part because the lack of direct links eliminates one of Taiwan's main advantages -- its close proximity to China, the most rapidly growing economy in the region. The American Chamber of Commerce in Taipei and other foreign business interests have repeatedly told Taiwan (and AIT) that with direct links, expatriates who might otherwise need to reside in the Mainland could opt to live in Taiwan. They underscore Taipei's conveniences and high standard of living. As an example, air quality, one of

Taiwan's advantages has only improved with the migration of manufacturing to the Mainland. At the same time, poorer air quality has hurt Hong Kong's attractiveness as a home for expatriate businessmen.

--Foreign Trade - Less expensive air cargo costs would only increase the competitiveness of Taiwan's exports to the Mainland. More rapid and efficient transportation could reduce pressure on some firms to move manufacturing operations to the Mainland in order to stay integrated in industry supply chains.

--Residents - In addition to expatriate businessmen, direct links could allow some Taiwan investors now resident in the Mainland to move back to Taiwan. By some accounts, Taiwan investors and their families total as many as one million residents in the PRC. Some market observers believe that anticipation of direct flights has helped fuel recent strong performance in Taiwan's residential property market.

--Tourists - Taipei and Beijing are currently discussing further opening Taiwan to PRC tourists. Many hope that Taiwan can replicate the experience of Hong Kong, where PRC tourists have made a major contribution to recent growth. Direct flights would facilitate PRC tourism to Taiwan.

Moving Forward

19. (SBU) Some of the important recent milestones in cross-Strait aviation include the following:

--January 2003 First Lunar New Year (LNY) Charters - For the first time, Taiwan airlines carried passengers from Shanghai to Taiwan before the holiday with return flights to the Mainland afterwards. The flights carried passengers in one direction only on each roundtrip flight. The flights had to land in Hong Kong before

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proceeding to Shanghai. Passengers were limited to Taiwan investors in the PRC and their families. In all, the six Taiwan airlines flew a total of 16 flights (ref K).

--January 2005 Two-Way, Non-Stop LNY Charters - Taipei and Beijing were unable to reach agreement on charter flights for the LNY holiday in 2004. However, for 2005, they agreed that Chinese airlines would participate in the flights. Planes carried passengers in both directions on each roundtrip across the Strait. In addition, planes did not have to land in Hong Kong en route. Instead, they passed through Hong Kong airspace. PRC destinations were expanded to include Beijing and Guangzhou. However, passengers were again limited to Taiwan investors and their families. Taiwan and PRC airlines flew a total of 96 flights over the course of about 3 weeks (ref J).

--August 2005 PRC Overflight - Taiwan announced in August 2006 that it would permit Taiwan airlines to seek permission from the PRC to fly through Chinese airspace on routes to Europe and the Middle East. PRC aviation authorities have generally approved these requests (ref I).

--January 2006 LNY Charters Further Expansion - LNY holiday charters were expanded in 2006 to include Xiamen as an additional PRC destination. In addition, passenger restrictions were relaxed to include any Taiwan passport holder with valid PRC entry documents, employees of Taiwan companies, and their family members. A total of 144 flights were operated over more than 3 weeks (ref H).

--June 2006 Institutionalized Holiday Charter Flights - On June 14, 2006, Taipei and Beijing announced an agreement to implement charter flights during each of four major holidays -- LNY, Tomb Sweeping Festival, Dragon Boat Festival, and Mid-Autumn Festival. Eligible passengers are still limited to the same restrictions for 2006 LNY charter flights. Airlines will fly 192 flights over 4 weeks during the LNY holiday and 48 flights over 2 weeks during each of the other three holidays. This expands charter flights to a total of 336 flights during 10 weeks of the year. The first round of holiday charters under the new agreement was conducted for the Mid-Autumn Festival in September and October 2006. The next round for the Lunar New Year holiday will begin on February 5 (ref G).

--June 2006 New Charter Flights - In addition, the two sides agreed in June to allow special cargo, medical emergency and humanitarian charters. The special cargo charters are limited to flights chartered to carry the cargo of a single firm. To date, the only cargo charters have been contracted by Taiwan Semiconductor Manufacturing Company (TSMC). It chartered five flights to carry equipment to its factory in China. Seven medical emergency charters have been conducted. To date, there have been no humanitarian charters. Some observers have commented that it is unclear what would be categorized as a humanitarian charter but fall outside the scope of medical emergency charters (ref G).

Comment - Stopping Short

110. (C) These events show that the two sides have made significant progress, but the current situation still falls far short of what the business community seeks. Regularly scheduled, frequent, widely accessible cross-Strait air travel would help Taiwan, U.S. and other foreign businesses. It could have a transformational effect on Taiwan's economy, assisting its efforts to become a regional operations and logistics center, develop the service sector and prevent economic marginalization. Taipei and Beijing are currently engaged in industry-led discussions on a more extensive set of frequent cargo and weekend passenger charter

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flights as reported refs B and C. Nonetheless, political considerations on both sides continue to block more significant progress on direct air links. AIT has publicly supported American businesses in encouraging Taiwan to move forward on this most important of cross-Strait economic initiatives. End comment.
YOUNG